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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of

Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services) CC Docket No. 96-112

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COMMENTS OF THE CALIFORNIA CABLE TELEVISION ASSOCIATION

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COMMENTS
OF THE CALIFORNIA CABLE TELEVISION ASSOCIATION

The California Cable Television Association ("CCTA") hereby submits its comments on the Notice of Proposed Rulemaking ("NPRM") in the above-captioned proceeding.[1] CCTA is a trade association representing cable television operators with over 400 cable television systems in California, including both small rural systems and national multiple system operators.

CCTA's members are potential facilities-based competitors of local telephone companies in the provision of local exchange telephone services to the public in California. CCTA's members also currently compete with Pacific Telesis Enterprises ("PTE") as it provides wireless video services under the name of Cross-Country Wireless. PTE expects to cover seven million homes with 100 channel digital MMDS service by 1997.[2] Its local exchange carrier ("LEC") affiliate, Pacific Bell ("Pacific"), has applied for a cable franchise

[1] In the Matter of Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services, Notice of Proposed Rulemaking, CC Docket No. 96-113, FCC No. 96-214 (May 10, 1996) ("NPRM").

[2] See Pacific Telesis Release, Wireless Digital Television - Frequently Asked Questions, available at www.pactel.com (Jan. 30, 1996).

in San Jose where it currently serves 1000 customers[3/] and has constructed a significant amount of hybrid fiber-coaxial cable ("HFC") facilities throughout the state. The second largest LEC in California, GTE, has been awarded cable franchises in Ventura County, California.[4/] While several of CCTA's members have applied for permission to provide local telephone service in California, they currently serve no customers as they await final local competition rules from the California Public Utilities Commission ("CPUC") and the Federal Communications Commission ("FCC" or "Commission"). For these reasons, CCTA's members have a strong interest in having the significant cost allocation issues resolved in the most pro-competitive fashion so as to achieve the facilities-based goals of the Telecommunications Act of 1996 ("1996 Act").[5/]

INTRODUCTION AND SUMMARY

CCTA wholeheartedly agrees with the Commission that there are significant problems with the Commission's existing Part 64 allocation methodologies.[6/] As a result of its participation in proceedings concerning Pacific's HFC deployment in California in connection

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3/ See Ex Parte Letter from Howard J. Symons, outside counsel for Tele-Communications, Inc., to Jackie Chorney, Legal Advisor to Chairman Reed Hundt, Federal Communications Commission (May 17, 1996).

4/ See "GTE Media Ventures Signs Its First Cable TV Franchise," Telecommunications Reports at 26 (Feb. 12, 1996).

5/ Telecommunications Act of 1996, Pub. L. No. 104-104, 101 Stat. 56.

6/ See NPRM, supra, note 1, ¶¶ 2, 16-21.

with the planned introduction of video and other broadband services,[7] CCTA has experienced firsthand the impact of cost misallocations through Pacific's behavior in California. Not only do these misallocations threaten to saddle still captive telephone ratepayers with the costs and risks associated with entry into competitive lines of business,[8] but, as the Commission recognized, the improper allocation of facilities' costs, network service expenses, and overheads can distort the competitive playing field.[9] Significantly, cost misallocations can occur not only because the Commission's Part 64 rules do not address fully the robustly competitive and open marketplace envisioned by the 1996 Act, but also because incumbent LECs are deliberately acting anticompetitively by shifting costs to regulated services and by failing to reveal, even to concerned regulators, the true nature of their activities and the costs involved.[10]

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[7] See, e.g., Applications of Pacific Bell for Authority Under Section 214(a) of the Communications Act to Construct Video Dialtone Facilities, Files Nos. W-P-C 6913-6916. CCTA Petition to Deny Pacific Bell's Section 214 Video Dialtone Applications (Feb. 9, 1994); Ex Parte letter from CCTA to Kathleen M.H. Wallman, Chief, Common Carrier Bureau, Federal Communications Commission, Reply Declaration of Leland L. Johnson, Ph.D., Declaration of Robert A. Mercer, Ph.D. (Jan. 6, 1995); Ex Parte letter from CCTA to Kathleen M.H. Wallman, Chief, Common Carrier Bureau, Federal Communications Commission, Second Reply Declaration of Leland L. Johnson, Ph.D., Declaration of Robert A. Mercer, Ph.D. (Jan. 20, 1995); Ex Parte letter from CCTA to Kathleen M.H. Wallman, Chief, Common Carrier Bureau, Federal Communications Commission, Declaration of Leland L. Johnson, Ph.D.. Declaration of Robert A. Mercer, Ph.D. (April 11, 1995).

[8] See FCC Monitoring Report, CC Docket No. 87-339, Table 6.1(a) (rel. May 1995). California LECs reported overall "revenues and other operating items" of approximately $11 billion dollars for 1994. Id. (source ARMIS Quarterly Report 43-01).

[9] See, NPRM, supra, note 1, ¶¶ 22-25.

[10] See, supra note 7; infra notes 20-25.

Consequently, CCTA applauds the critical assessment of these basic issues in this NPRM. We urge the Commission to bear in mind the incentives of the incumbent LECs to chill genuine facilities-based competition while they simultaneously seek to use all available legal and anticompetitive means to construct and market broadband facilities and services. As experience has taught that the Commission's cost allocation rules cannot in themselves prevent anticompetitive cost shifting, the Commission must adopt clear rules to identify and classify costs and require incumbent LECs to provide complete and accurate data to ensure that there is full compliance with the Commission's rules. The Commission's video dialtone experiences, where vital cost information had to be extracted from the LECs over an extended period of time,[11/] underscore the critical need for complete and accurate data in a cost allocation regime.

In addition, the Commission should also adopt a cost ceiling for regulated service costs to ensure that the LECs' decisions to deploy joint use facilities do not put ratepayers in a worse position than they would have been otherwise. With respect to the alternative presented in the NPRM, CCTA believes that a specific gross allocator, properly set, is the best way to protect the marketplace from being distorted by LEC cross-subsidies. CCTA asserts that, on the basis of its experience with the network that Pacific has proposed to deploy for video services and data with respect to broadband investment, at least 76% of these costs should be allocated to non-regulated services. Finally, the Commission should consider adopting rules to ensure that telephone ratepayers do not bear the costs of spare facilities designed for LEC entry into competitive services.

[11/] See infra, note 13.

I. THE COMMISSION HAS CORRECTLY ACKNOWLEDGED THAT PART 64 RULES ARE INADEQUATE IN THE OPEN COMPETITIVE MARKETPLACE CREATED BY THE 1996 ACT

A. The Commission's Rules Cannot Protect Against Anticompetitive Conduct on Joint Use Facilities

CCTA applauds the Commission's decision to address separately the cost allocation issues that arise with an incumbent LEC's use of the same network facilities to provide video programming services and other competitive offerings not subject to Title II regulation, with its telephony and other Title II offerings. As the Commission noted in the NPRM, the Commission's current Part 64 cost allocation rules were not designed to allocate common costs on joint-use networks between nonregulated offerings that will be introduced by incumbent LECs and the regulated services they already offer.[12/] The Commission's decision to amend its Part 64 rules represents a critical component of its effort to construct a policy framework that deters LEC cross-subsidization and anticompetitive predatory conduct. Moreover, it advances the policy goals of ratepayer protection and the encouragement of fair competition in the video services marketplace. Indeed, such a result is mandated by Section 254(k) of the Communications Act, added by the 1996 Act, which bars a telecommunications carrier from "us[ing] services that are not competitive to subsidize services that are subject to competition."[13/]

The Commission's system of accounting safeguards was put in place in order to protect ratepayers from bearing the costs and risks of nonregulated activities.[14/] Currently,

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[12/] See NPRM, supra, note 1, ¶ 2.

[13/] 47 U.S.C. § 254(k).

[14/] See NPRM, supra, note 1, ¶ 9.

all incumbent LEC revenues, expenses, and investments are recorded according to the Uniform System of Accounts ("USOA"), which is contained in Part 32 of the Commission's rules. Regulated and non-regulated expenses are separated using the FCC's Part 64 cost allocation rules. State and interstate expenses are then determined through the Part 36 separations rules, while Part 69 is used to apportion expenses among interstate services. Finally, the Commission's price cap rules are used to generate prices for non-competitive Title II services.

Because the Part 64 cost allocation process between regulated and nonregulated activities is premised upon the system of accounts recorded in the USOA, to the extent that the USOA does not reflect the characteristics of a LEC's integrated network, Part 64 is inadequate. As an example, Part 32 of the Commission's rules does not provide separate accounts for loops and trunks, thus enabling a LEC to record interoffice fiber trunk investment and fiber in the loop in the same USOA account. In addition, the Commission's Part 32 USOA accounts -- many of which were established before the advent of today's robustly competitive market -- have not always kept pace with the rapid technological changes that have taken place in the telecommunications industry. As a result of such deficiencies in the USOA, incumbent LECs retain considerable discretion as to how costs are ultimately apportioned among regulated and nonregulated service categories.

Notwithstanding the inherent limitations of the Part 32 USOA accounts, the Commission has also stressed that its Part 64 cost allocation process was never designed to resolve the basic cost allocation questions that are presented with the deployment of integrated video/telephony networks.[15] Rather, the Part 64 rules were developed for more "traditional" and less far-reaching nonregulated services such as electronic messaging[16] and payphone message delivery service.[17] Indeed, CCTA agrees with the Commission's findings that as new technologies make it possible to offer both regulated and nonregulated services simultaneously over the same facilities, it is no longer possible for the Commission to assign directly those facilities to either regulated or nonregulated activities under the current cost allocation scheme.[18]

The limitations of the existing Part 64 cost allocation process are most readily apparent with respect to loop plant, which traditionally has been almost exclusively dedicated to provision of regulated telephony services. As new technologies are deployed whereby the same loop plant can offer both regulated and nonregulated services, direct assignment to either class of service is no longer possible. Furthermore, neither can the Commission allocate costs solely on the basis of usage as it has traditionally done when direct assignment is not used (such as for switching costs), because loop plant is deemed not to be traffic sensitive, a prerequisite for usage-based allocation.

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[15] See NPRM, supra, note 1, ¶¶ 2, 16-21.

[16] See, e.g., Pacific Bell's CAM for the Separation of Regulated and Nonregulated Costs, 6 FCC Rcd 5196 (1991).

[17] See, e.g., Ameritech Files Revisions to its Cost Allocation Manual Associated with the Market Trial or Payphone Message Delivery Service, Public Notice, 10 FCC Rcd 9359 (1995).

[18] See NPRM, supra note 1, ¶¶ 2, 16-21.

B. Experience Teaches That Prospective Generic Rules Will Go A Long Way to Protect the Marketplace from LEC Attempts at Anticompetitive Conduct

Recognizing some of the shortcomings of its existing rules as applied to developing technology, the Commission tentatively concluded that its current joint cost methodology for allocating the costs of a LEC's integrated facilities between regulated and nonregulated services neither met the requirements of the 1996 Act, nor its own Part 64 regulations.[19/] Record evidence and experience suggest that the current cost allocation process has not been successful in preventing the cross-subsidization of competitive services by regulated activities.

Pacific has historically attempted to impose on its ratepayers the costs and risks of their competitive ventures on numerous occasions. For example, a NARUC audit of Pacific Telesis uncovered important instances of cross-subsidization of its competitive services by its regulated telephone services amounting to hundreds of millions of dollars of investment and expense in competitive broadband development.[20/]

[19/] See NPRM, supra, note 1, ¶ 24. The Commission lays out a series of requirements that any cost allocation principles adopted in this proceeding should balance: "administrative simplicity; adaptability to evolving technologies; uniform application among incumbent local exchange carriers . . . ; and consistency with economic principles of cost causation."

[20/] See National Association Regulatory Utility Commissioners, An Audit of the Affiliate Interests of the Pacific Telesis Group, July 1994. Specifically, the audit revealed that Pacific made certain infrastructure modifications to enhance its competitive services at the expense of the ratepayers, Id. at B-9; it employed the same personnel on competitive and non-competitive applications without separately accounting for the time spent on each project, Id. at B-16; and cross-subsidized its competitive electronic publishing ventures using regulated services revenue. Id. at C-85.

Recently disclosed audit reports[21] reveal that the FCC itself has repeatedly found Pacific to be engaged in cross-subsidization. First, in June of 1990, the FCC found that: (i) Pacific understated the amount of travel being allocated to nonregulated activities; (ii) Pacific technicians improperly charged the entire cost of "no access" and "no trouble" found visits to regulated activities; and (iii) that Pacific improperly classified nonregulated expenses associated with customer premise equipment as regulated.[22] Second, in December of 1990, the FCC found errors in Pacific's reporting of labor expenses, finding that it improperly shifted the costs of nonregulated activities to regulated service accounts.[23] Third, in October of 1991, the FCC found Pacific's procedures for identifying productive and nonproductive time to be both inadequate and improperly recorded to regulated activities.[24] Finally, in March of 1992, the FCC found that Pacific employees working on nonregulated products were charging their time to regulated services.[25]

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[21] See In the Matter of E.T. Kennedy On Request for Inspection of Records, FOIA Control No. 92-229 (rel. Feb. 12, 1996).

[22] Letter from Jose-Luis Rodriguez, Chief, Audits Branch, to Frank Hopwood, Director, Federal Regulatory Matters, Pacific Telesis Corporation (June 19, 1990).

[23] Letter from Jose-Luis Rodriguez, Chief, Audits Branch, to Kendall T. Murphy, Vice President, Quality and Controller, Pacific Bell Telephone Company (December 18, 1990).

[24] Letter from Jose-Luis Rodriguez, Chief, Audits Branch, to Karen Nishida, Director, Federal Regulatory Matters, Pacific Telesis Corporation (October 30, 1991). Pacific also improperly charged all no trouble found time, no access time, and CPE time to regulated activity. Id.

[25] Letter from Jose-Luis Rodriguez, Chief, Audits Branch, to Sheryl Herauf, Director, Federal Regulatory Matters, Pacific Telesis Corporation (March 20, 1992). The FCC found that Pacific also incorrectly charged all time spent by the company issuing an "Educational Disclosure Statement" to regulated activity even though it included product offerings in the statement. Id.

Indeed, with respect to Pacific's deployment of HFC facilities, CCTA and others presented strong evidence that Pacific intended to vitiate the Commission's current Part 64 cost allocation structure by attempting to charge off the bulk of investment in broadband facilities to telephony, despite the existence of well-functioning telephone networks.[26/] Pacific, for instance, initially proposed to allocate to telephone service as much as 95 percent of its investment in hybrid fiber-coaxial networks in four metropolitan areas in California.[27/] CCTA and several diverse parties, including the CPUC, objected to Pacific's shift of costs to its telephone ratepayers.[28/]

Throughout the Pacific video dialtone proceedings and elsewhere, CCTA repeatedly asked the Commission to establish at the outset a coherent and verifiable policy grounded in sound economic principles for the allocation of the costs of an integrated system.[29/]

[26/] See supra note 7.

[27/] Only after a year and a half and diligent and persistent efforts by the Common Carrier Bureau, Pacific "relented" and reduced this to 78 percent. See Letter from Alan Ciamporcero, Pacific Telesis to Kathleen M.H. Wallman, FCC, dated March 21, 1995, at 5-9.

[28/] In its comments, the CPUC suggested an allocation based on minutes of use that would have resulted in an allocation ratio to video services at a rate of more than 18 times that allocated to telephony services on Pacific's HFC network. See Applications of Pacific Bell, File Nos. W-P-C 6913-6916, Comments of the People of the State of California and the CPUC on Section 214 Applications, at 12-14, n.8 (filed Feb. 8, 1994). In a later filing, the CPUC warned the Commission that California price cap regulation could not protect Pacific's telephone ratepayers from misallocation of HFC costs. See, Applications of Pacific Bell, File Nos. W-P-C 6913-6916, ex parte letter from Mark Fogelman, Principal Counsel, CPUC, to William F. Caton, Secretary, FCC (filed Jan. 19, 1995).

[29/] See, e.g., supra note 7; see also Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, CCTA Comments (filed May 9, 1994); CCTA Reply Comments (filed June 29, 1994); Price Cap Performance Review for Local Exchange Carriers, Treatment of Video Dialtone Service Under Price Cap Regulations, CC Docket No.
(continued...)

Although the Commission recognized that the LECs had the potential to engage in anticompetitive conduct by "imposing added costs on the monopoly ratepayer by cross-subsidizing . . . new broadband services,"[30] the Commission determined that, in the video dialtone context, it would be better to address pivotal cost allocation issues on a case-by-case, ad hoc basis, which ultimately proved to be extremely time consuming for all parties. Addressing these critical issues of cost allocation now in an efficient manner that is consistent with the principles of cost causation is a major step in ensuring that the video dialtone experience will not be repeated.

C. The Commission Should Require Incumbent LECs to Provide Full and Accurate Data to Ensure Compliance

While CCTA is encouraged by the Commission's decision to establish a cost allocation methodology to amend the cost allocation deficiencies that remained unchecked during the video dialtone proceedings, CCTA remains concerned that other aspects of the Commission's regulatory framework may still allow LECs to understate costs of broadband plant and overstate the costs of telephone service, leading to higher telephone rates and unfair competition. Indeed, incumbent LECs seeking to become OVS or cable operators are new entrants in the video marketplace with powerful economic assets and the intense desire to

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[29](...continued)
94-1, CCTA Comments at 12-14 (filed April 17, 1995); CCTA Reply Comments at 16-19 (filed May 17, 1995).

[30] Telephone Company-Cable Television Cross Ownership Rules, Notice of Proposed Rulemaking, 2 FCC Rcd. 5092, 5093 (1987).

dominate the industry.[31] They still have every incentive to gain an improper competitive edge in the marketplace, especially by setting prices particularly low, utilizing monopoly power to gain market share as quickly as possible.[32] This is particularly true now, as video competition already exists in California, while facilities-based telephone competition does not yet provide any market restraint against cross-subsidy.[33]

Given these incentives, the Commission's rules should explicitly require incumbent LECs to provide complete and accurate information regarding the costs and investment of their integrated facilities.[34] Any improper or incomplete recordation of such costs and investments, may, in turn, understate the costs of video capabilities and thwart video competition by giving the LEC an unfair market advantage over competitors that lack the

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[31] See, e.g., "PacTel Takes Dead Aim at Cable," Multichannel News at 1, 32 (March 18, 1996); "PacTel Readies Fall Attack on L.A.-Area Cable Systems," Cable World at 1, 50 (Feb. 26, 1996).

[32] See "Interview with Lee Camp," Inside Line News Bulletin at 3 (Sept. 27, 1995); "Pacific Telesis Telco to Offer Wireless Cable Television,"; Press Release (July 25, 1995) (quoting Pacific CEO Michael Fitzpatrick).

[33] See e.g., In the Matter of Price Cap Performance Review For Local Exchange Carriers, Second Further Notice of Proposed Rulemaking in CC Docket No. 94-1, FCC 95-393, Comments of CCTA at 5 (filed Dec. 11, 1995).

[34] See Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, CCTA Comments (filed May 9, 1994); CCTA Reply Comments (filed June 29, 1994); Price Cap Performance Review for Local Exchange Carriers, Treatment of Video Dialtone Service Under Price Cap Regulations, CC Docket No. 94-1, CCTA Comments at 12-14 (filed April 17, 1995); CCTA Reply Comments at 16-19 (filed May 17, 1995).

ability to off-load costs to a base of regulated customers.[35] The Commission should be concerned not only with the allocation of costs the LEC deems common, but also with whether the so-called direct costs are properly allocated.[36]

The most important protection against improper cross-subsidization continues to be the proper allocation of non-regulated costs based upon accurate and complete information for all costs. CCTA believes that the Commission's tentative decision to establish fixed cost allocation factors which generally adhere to basic principles of cost-causation, combined with the submission of complete and accurate cost and investment information, will minimize the risk of cross-subsidization and anticompetitive behavior that plagued video dialtone and ensure that the proper tools exist for thorough and vigorous enforcement.

II. THE COMMISSION SHOULD ESTABLISH A FIXED ALLOCATION FACTOR BASED UPON THE ACTUAL NETWORKS THE LECS INTEND TO CONSTRUCT

The Commission tentatively concludes that to address the cost allocation problems created by generation of common costs in loop plant and the distortion that usage based cost assignment will introduce, it " . . should prescribe specific cost pools and allocation factors

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[35] The FCC recently noted that its affiliate transaction rules, if not strictly adhered to, could invite abuse by the LECs resulting in "ratepayers' improperly absorbing the costs of nonregulated services." See In the Matter of Citizens Utilities Company Permanent Cost Allocation Manual for the Separation of Regulated and Non-Regulated Costs, File No. AAD 94-6, at ¶¶ 11, 18 (rel. Apr. 22, 1996)("[C]osts recorded in regulated accounts for transactions between a carrier and its nonregulated affiliates . . . can lead to cross-subsidies because they can be links in transactional chains that result in inflated costs being recorded in other Part 32 accounts.").

[36] Applications of Pacific Bell, FCC 95-302, File Nos. W-P-C 6913-16, Order and Authorization at ¶ 94 (The Commission deferred any decision regarding Pacific Bell's classification of network interface units and host digital terminals as direct telephony investment until the tariff review process).

in this proceeding for allocating video programming and other nonregulated service costs."[37] To that end, the Commission seeks comment on determining a fixed allocator scheme consistent with the 1996 Act.

A. The Commission Should Adopt A Cost Ceiling for Regulated Service Costs

Before the Commission embarks on a search for a reasonable fixed allocator, it must first address a related issue. To borrow a phrase from the medical profession, the Commission must first insure that the proposed new hybrid networks of the LECs, "first do no harm" to the regulated ratepayer. Thus, the LECs assert that a principal benefit of the hybrid networks is that in addition to offering consumers the benefits of video programming and other high-capacity services, these networks will generate significant cost savings for regulated ratepayer services through economies of scale. The Commission should hold the LECs to these claims by insuring that LEC hybrid networks leave regulated ratepayers at the very least no worse off, in terms of rates they pay for regulated telephony services, than they would have been with economic costing of the current plant that previously provided them with satisfactory telephone service. Indeed, given the fact that LECs have in many cases attempted to justify their plans for investing in hybrid networks based almost solely upon telephony, the Commission should insist that regulated ratepayers are put in a better position, from the standpoint of rates, than they would have been in with the current network.

One way to insure that regulated ratepayers are burdened with no more costs than they would have been burdened with if the hybrid system had never been deployed is to

[37] NPRM, supra, note 1, ¶ 27.

establish a ceiling on total costs that LECs may allocate to regulated services.[38/] CCTA submits that a cost ceiling for regulated services is a necessary complement to the fixed allocator that the Commission has tentatively determined it must establish as an alternative to direct assignment and usage-based allocation procedures. The reason for establishing a cost ceiling for regulated services before applying a fixed allocator is that a network design that involves a costly HFC network, with very high common costs, and very low direct costs, could quite easily result in regulated ratepayers being placed in a worse position, even after application of a reasonable fixed allocator, than they would have been if the HFC network had never been built.

For example, assume hypothetically that the current cost of a perfectly adequate network designed to provide regulated telephony services is $15, whereas the HFC network deployed by the LEC to provide both regulated telephony and nonregulated video programming services has a cost of $45. If the direct costs attributable to both telephone and video programming in the HFC network are each $10, the remaining $25 will be common costs. If a 50/50 fixed allocator is applied to the entire $25 of common costs, the regulated ratepayer will be burdened with costs of $22.50 ($10 direct plus one-half of $25 common = $22.50), rather than the $15 the ratepayer would have had to cover with the current network. Even a fixed allocator of 25/75, where 25 percent of common costs are assigned to regulated and 75 percent to nonregulated services, will leave the ratepayer in the above scenario worse off then if the HFC network had never been built ($10 direct costs plus one-quarter of $25 common costs = $16.25, versus $15 for the current network that served the regulated

[38/] See NPRM, supra, note 1 ¶¶ 35-36.

ratepayer perfectly well for his or her telephony needs). If, however, a cost ceiling of $15 had been established, because $15 is the current cost of providing telephony services on the existing network, the ratepayer in the above scenario would be burdened with no more than the $15 current cost of regulated services and would at least not be penalized by the LEC's desire to construct a high-capacity HFC network in order to provide nonregulated services

To establish a ceiling on the costs attributable to regulated services, the Commission must be able to calculate the cost of telephony services using current technology. It may be true, as the Commission notes. "[W]e cannot know these amounts precisely,"[39/] but as the Commission recognized in another recently released Notice of Proposed Rulemaking, studies do exist that can measure the cost of providing local service.[40/] Indeed, many of the cost studies cited by the Commission are forward-looking studies based on TSLRIC principles and include the types of network investments and expenses specified in the NPRM.[41/] In addition, while such studies are generally designed to establish the overall cost of providing local service, they may shed light on the cost of individual components of the overall local network; e.g., loops, switching, interoffice.

[39/] NPRM, supra, note 1, ¶ 35.

[40/] In the Matter of Implementation of Local Competition Provisions in the Telecommunications Act of 1996, CC Docket 96-98, Notice of Proposed Rulemaking, released April 19, 1996, at ¶ 137 ("Interconnection NPRM").

[41/] NPRM, supra, note 1, ¶ 36.

B. The Commission Should Establish A Fixed Allocator For Integrated Networks That Allocates At Least 76 Percent of Costs to Non-Regulated Services

As noted above, CCTA supports the Commission's assessment that traditional methodologies of direct allocation and allocation based on usage are not adequate to assign costs in an integrated, hybrid network, given the high levels of common costs. CCTA further supports the Commission's tentative conclusion that fixed allocation factors should be established to allocate common costs between regulated and nonregulated services. A fixed allocator must meet the 1996 Act's mandate that LECs may not use their regulated services to subsidize competitive services[42/] and must be permissible under the Commission's discretionary authority.[43/] There is ample legal authority for the Commission to establish a fixed allocator for common costs as an alternative to usage-based measures. Fixed allocators have been used by the Commission in the past to allocate common costs generated by telecommunications networks, such as in allocating costs between interstate and intrastate regulated services,[44/] and in the use of a fixed factor for allocating loop plant as an alternative to usage-based allocator.[45/]

[42/] Telecommunications Act of 1996, Pub. L. No. 104-104, 101 Stat. 56, Sec. 101(a), § 145(k) (1996).

[43/] See 47 C.F.R. § 1.3.

[44/] NPRM, supra, note 1, ¶ 37. Also cited are the Commission's practice of prescribing certain billing expenses on a fixed basis, and allocation of residual circuit equipment costs by interexchange carriers.

[45/] Id., ¶ 37 and n.51 (citing Rural Telephone Company v. F.C.C., 838 F.2d 1307, (D.C. Cir. 1988)).

The Commission notes that a 50 percent factor would split costs equally between regulated and nonregulated services and would satisfy the Part 64 principles laid down in the NPRM -- administratively simple, adaptable to evolving technologies, consistent for all LECs, and a reasonable alternative to cost-causative methods that, for reasons previously described, cannot reasonably be applied.[46/] While the Commission may be attracted by the very simplicity of a 50 percent allocator, CCTA believes the experience to date with the networks that the LECs are actually proposing dictates using a fixed allocator that assigns a portion of common costs to the unregulated services that is significantly greater than 50 percent.

Indeed, a 50-50 allocator ignores the critical fact that there is already in place a fully functioning and reliable local telephone network providing local telephone customers with reasonably priced services. Ratepayers have already funded substantial modernization of that network, including substantial investment in digital switching and fiber optic transmission. For example, Bell Operating Company fiber links more than tripled between 1989 and 1993, while lines served by digital switches almost doubled.[47/] Consumers should now be reaping the benefits of these prior investments through high productivity factors that will lead to lower prices.[48/] Scrapping this network primarily because LECs want to provide unregulated competitive video and other services will put ratepayers in the position of having to fund new

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[46/] Id., ¶ 39.

[47/] See FCC, Monitoring Report, May 1995, Table 8.2, p. 495 and Table 8.1, p. 485.

[48/] See, e.g., Applications of Pacific Bell, File Nos. W-P-C 6913-6916, Application at 5 (filed Dec. 20, 1993).

investments while the old investments are still being depreciated. Such a result is clearly contrary to the public interest.

TSLRIC cost models calculate that the investment necessary to provide loops for basic telephone service is approximately $361 per loop.[49] Therefore, the ceiling for basic telephone should be $361 per loop. On the other hand, a LEC has testified that it found in actual practice that the loop investment necessary to overlay a broadband network over an existing network was $1,500 per loop.[50] Therefore, if the ceiling is $361, and the investment for broadband has been found to be $1,500, the maximum portion of common costs that should be allocated to regulated telephony ratepayers should be 24 percent (361/1500 = 0.24), and, it follows, that the minimum portion of common costs allocated to non-regulated services should be 76 percent. This is a bare minimum since LECs consistently allege that ratepayers will be able to reap the benefit of efficiencies embedded in hybrid networks. In other words, the fixed allocator the Commission should use to allocate

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[49] See In the Matter of the Request for Agency Action of Phoenix Fiberlink of Utah, Inc. For Authority to Provide Intrastate Telecommunications Services in the State of Utah, et al., Direct Testimony of Robert A. Mercer on Behalf of AT&T Communications of the Mountain States, Inc. (filed March 14, 1996). See also Central Telephone Company - Nevada, Residential Basic Service Incremental Cost Study, August 1995, wherein it is reported the loop investment necessary to provide basic telephone service is $357 per loop.

[50] Surrebuttal testimony of Geraldine G. Santos-Rach, Director-Product Cost Specialist, US WEST Communications, Inc., submitted to the Public Service Commission of Utah in Dockets No. 95-2206-01, 94-2202-01 and 94-999-01, May 1, 1996, at p. 4.

common costs between regulated and non-regulated services is 24 regulated/76 non-regulated.[51/]

Such an allocator would have the benefit of fundamental fairness. Moreover, such an allocator is more likely to provide regulated consumers with the benefits of any economies of scale that may be derived from an HFC network, unlike a 50/50 split.

In fact, such a result is consistent with the Commission's own statements:

> ". . . [O]ur rules will intentionally allocate a significant part of common costs to nonregulated services. This is appropriate because we believe that telephone ratepayers are entitled to at least some of the benefit of the economy of scope between telephony and competitive services."[52/]

In the end, perhaps the strongest support for an allocation of 24% to telephony and 76% to broadband services is simple common sense.[53/] Telephone ratepayers do not need these hybrid networks. They run the risk, without the option to say "no," of being saddled with broadband costs. They should not be asked also to run the risk of having to subsidize video and data services that they may not need or want.

[51/] In keeping with the Commission's view that cost allocation principles should be administratively simple, adaptable and uniformly applicable, when an allocator can be established based on reasonable investment figures, it would seem the wisest course to apply that allocator across the board to allocate regulated and unregulated common expenses as well.

[52/] <u>NPRM</u>, <u>supra</u>, note 1, ¶ 23.

[53/] Of course, this allocation necessarily assures that LEC will utilize their networks in a truly integrated fashion. Telephone ratepayers should not be required to bear the costs of LEC "hybrid" networks that will, in fact, provide only broadband services for a significant period of time.

C. **The Commission Should Consider Rules to Prevent Ratepayers From Bearing the Costs of Spare Facilities Designed for Competitive Services**

CCTA agrees with the Commission "that Congress did not intend that telephone exchange service or exchange access subscribers pay rates designed to recover the costs of spare capacity that eventually will be used for video programming and other services that may be competitive."[54/] CCTA notes that the Interconnection NPRM is dealing with the issue of establishing reasonable prices for interconnection and unbundled network elements.[55/] As a number of parties in that proceeding suggest, these prices should be set on the basis of TSLRIC,[56/] which does include reasonable spare capacity, but does not include capacity constructed for future unregulated or competitive services.

Consistent with these principles, all spare capacity in excess of a reasonable amount in place for regulated services, should be assigned to the unregulated category instead of being assigned on the basis of peak use projected over a three year period. This issue, as the Commission notes, is broader than the video allocation issue. Companies that do not construct video facilities may still have excessive amounts of spare capacity for Centrex or other competitive services such as long distance. The Commission should establish a separate proceeding to deal with this issue. The primary purpose of such a proceeding would be to identify the appropriate amount of spare capacity to be assigned to the regulated

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[54/] NPRM, supra, note 1, ¶ 53.

[55/] See supra note 40.

[56/] See e.g., Interconnection NPRM, CC Docket 96-98, Comments of The National Cable Television Association at 50 (filed May 16, 1996).

category. With evolving competition, LECs should not be given the flexibility to carry on the regulated books spare capacity intended or primarily useful for unregulated services.

CONCLUSION

In California, the LECs have entered the video marketplace. Wireless plant will pass seven million homes by the end of 1997. Pacific and GTE are deploying wireline plant for cable television service and, perhaps for OVS service. In the meanwhile, these companies retain their monopoly over local telephone service. In this context, it is vitally important to fix an allocator that reflects the 1996 Act's twin policies of encouraging facilities-based competition and protecting telephone ratepayers from cross-subsidy.

For the foregoing reasons, CCTA requests that the Commission: prescribe prospective, generic Part 64 rules in a manner that is consistent with the economic principles of cost causation; require incumbent LECs to provide complete and accurate cost and investment data; establish a ceiling on the costs attributable for regulated services; and adopt a fixed allocator for integrated networks that allocates at least 76% of costs to non-regulated services while ensuring that telephone ratepayers do not bear the cost of spare facilities designed for LEC entry to competitive services.

Respectfully submitted,

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